# Weekly Trends

PRIVATE CLIENT SOLUTIONS

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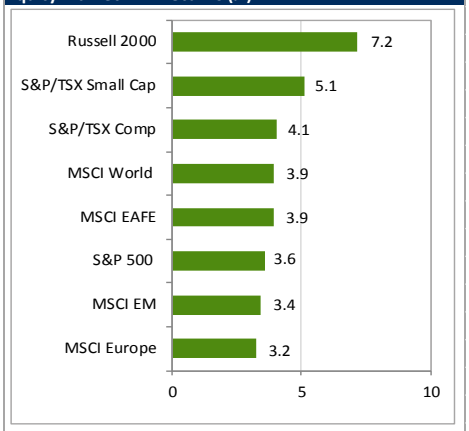
January 11, 2019

## China: Canary in the Coal Mine

A resolution to the trade spat between the US and China is seen by many as the panacea for the current market rut. We're not so sure. A trade deal will certainly improve investment sentiment, but it doesn't solve the fact that growth in the world's second largest economy is decelerating.

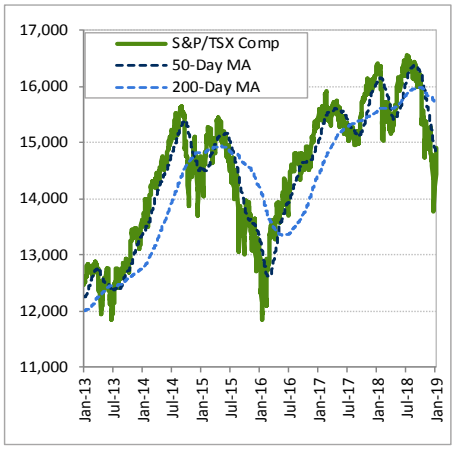
- To support the economy, government officials have taken steps to address the slowdown by lining up additional monetary and fiscal stimulus. While in the last few weeks the government announced plans to boost bond financing for private firms and cut taxes for households, it remains to be seen if the measures can reverse the trend.
- The stellar economic growth that China experienced in the 2000s was a boon to US corporations with exposure to the region. Today, that exposure can act as a headwind. Look no further than Apple's (AAPL-US) recent negative revision to its revenue guidance.
- Over the past decade, companies with exposure to China have produced solid gains relative to the S&P 500; however, we can see there are periods of underperformance (2010, 2015 and current).
- From a market timing perspective, what we find interesting from the chart above is that companies with exposure to China have lead market pullbacks by ~2 months.

**Equity Market YTD Returns (%)**



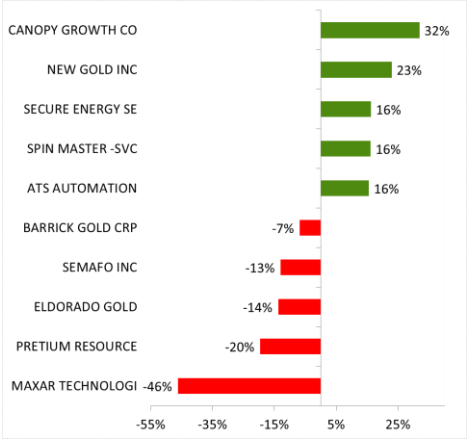

| Canadian Sectors | Weight | Recommendation |
|---|---|---|
| Consumer Discretionary | 4.3 | Underweight |
| Consumer Staples | 4.0 | Market weight |
| Energy | 18.4 | Market weight |
| Financials | 32.6 | Market weight |
| Health Care | 1.8 | Underweight |
| Industrials | 10.7 | Market weight |
| Technology | 4.0 | Market weight |
| Materials | 11.2 | Market weight |
| Communications | 5.8 | Market weight |
| Utilities | 4.0 | Market weight |
| Real Estate | 3.2 | Overweight |

| Technical Considerations | Level | Target |
|---|---|---|
| S&P/TSX Composite | 14,903 | 15,600 |




Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

**S&P/TSX Top 5 Gainers/Laggards***




**S&P/TSX Market Internals**

| | | |
|---|---|---|
| Weekly Advance | 180 | 72% |
| Weekly Decline | 56 | 22% |
| Advance-Decline | 124 | |
| New 52 wk high | 2 | 1% |
| New 52 wk low | 0 | 0% |
| No. Stocks Above 50-d | 141 | 56% |
| No. Stocks Above 200-d | 74 | 29% |
| Arms Weekly Index | 1.09 | Neutral |
| RSI (14-day) | 59.5 | Neutral |
| 50-DMA | 14,826 | Uptrend |
| 200-DMA | 15,692 | Downtrend |

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

**Please read domestic and foreign disclosure/risk information beginning on page** 5

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A resolution to the trade spat between the US and China is seen by many as the panacea for the current market rut. We're not so sure. A trade deal will certainly improve investment sentiment, but it doesn't solve the fact that growth in the world's second largest economy is decelerating. The slowdown in China has far more to do with internal factors rather than external pressures, such as trade. Looking at China's export data, we can see that the impact of trade tariffs has had a minimal impact on China's export growth in 2018. China posted a double-digit growth in all but three months of the year. The export resiliency can likely be explained by exports/imports potential front running more punitive tariffs imposed in late September and ahead of the potential jump in the tariff rate on $200 billion of Chinese goods. Such front loading may gradually fade to some extent and the negative impacts may begin to appear in 2019. If so, this could put further downward pressure on the Chinese economy, which continues to show signs that domestic growth is struggling. The deceleration in GDP growth, which began mid-year, has gained further momentum as indicated by recent inflation data that points to deflationary risks, weak retail sales and passenger vehicles sales.

To support the economy, government officials have taken steps to address the slowdown by lining up additional monetary and fiscal stimulus. While in the last few weeks the government announced plans to boost bond financing for private firms and cut taxes for households, it remains to be seen if the measures can reverse the trend.

## China Key Economic Data – Moving in the Wrong Direction

| Date | China GDP (YoY) | China Industrial Production (YoY) | China Retail Sales (YoY) | China Export Trade (USD YoY) | China PPI (YoY) | China Monthly Money Supply M2 (YoY) |
|---|---|---|---|---|---|---|
| January-17 | 6.9 | 6.0 | 10.9 | -6.2 | 5.5 | 11.3 |
| February-17 | | 6.0 | 10.9 | 7.5 | 6.9 | 10.7 |
| March-17 | | 6.0 | 10.9 | -1.7 | 7.8 | 10.4 |
| April-17 | 6.9 | 7.6 | 10.9 | 16.4 | 7.6 | 10.1 |
| May-17 | | 6.5 | 10.7 | 8.0 | 6.4 | 9.8 |
| June-17 | | 6.5 | 10.7 | 8.7 | 5.5 | 9.1 |
| July-17 | 6.9 | 7.6 | 11.0 | 10.3 | 5.5 | 9.1 |
| August-17 | | 6.4 | 10.4 | 6.4 | 5.5 | 8.9 |
| September-17 | | 6.0 | 10.1 | 4.9 | 6.3 | 8.6 |
| October-17 | 6.8 | 6.6 | 10.3 | 7.9 | 6.9 | 9.0 |
| November-17 | | 6.2 | 10.0 | 6.3 | 6.9 | 8.9 |
| December-17 | | 6.1 | 10.2 | 11.5 | 5.8 | 9.1 |
| January-18 | 6.8 | 6.2 | 9.4 | 10.9 | 4.9 | 8.1 |
| February-18 | | 6.2 | 9.4 | 10.6 | 4.3 | 8.6 |
| March-18 | | 6.2 | 9.7 | 43.5 | 3.7 | 8.8 |
| April-18 | 6.7 | 6.0 | 10.1 | -3.0 | 3.1 | 8.2 |
| May-18 | | 7.0 | 9.4 | 11.9 | 3.4 | 8.3 |
| June-18 | | 6.8 | 8.5 | 11.9 | 4.1 | 8.3 |
| July-18 | 6.5 | 6.0 | 9.0 | 10.7 | 4.7 | 8.0 |
| August-18 | | 6.0 | 8.8 | 11.6 | 4.6 | 8.5 |
| September-18 | | 6.1 | 9.0 | 9.5 | 4.1 | 8.2 |
| October-18 | 6.5 | 5.8 | 9.2 | 14.4 | 3.6 | 8.3 |
| November-18 | | 5.9 | 8.6 | 15.6 | 3.3 | 8.0 |
| December-18 | | 5.4 | 8.1 | 5.4 | 2.7 | 8.0 |

Source: Bloomberg, Raymond James Ltd.

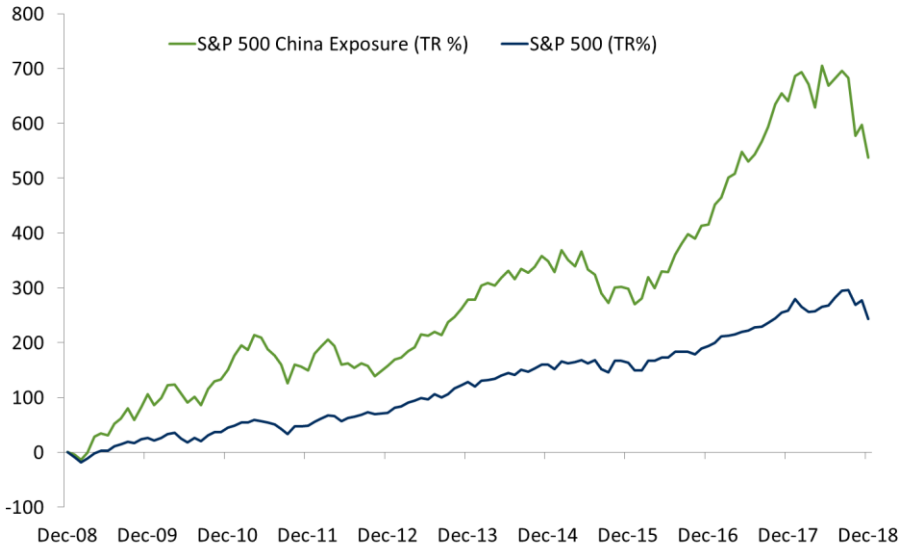
## Cuts Both Ways

The stellar economic growth that China experienced in the 2000s was a boon to US corporations with exposure to the region. Today, that exposure can act as a headwind. Look no further than Apple's (AAPL-US) recent negative revision to its revenue guidance. In CEO Tim Cook's letter to shareholders he wrote:

> "*While we anticipated some challenges in key emerging markets, we did not foresee the magnitude of the economic deceleration, particularly in Greater China. In fact, most of our revenue shortfall to our guidance, and over 100% of our year-over-year worldwide revenue decline, occurred in Greater China across iPhone, Mac and iPad.*"

To illustrate how China can help or hinder, we looked at US companies with exposure to the region. Over the past decade, companies with exposure to China have produced solid gains relative to the S&P 500; however, we can see there are periods of underperformance (2010, 2015 and current). Regardless, a buy-and-hold strategy over the past ten years has been a winning trade, as a China-exposure weighted portfolio of the top 20 companies has resulted in a 537% total return compared to the S&P 500 returning 242%.

**China Exposure a Winning Strategy Over the Long Haul**



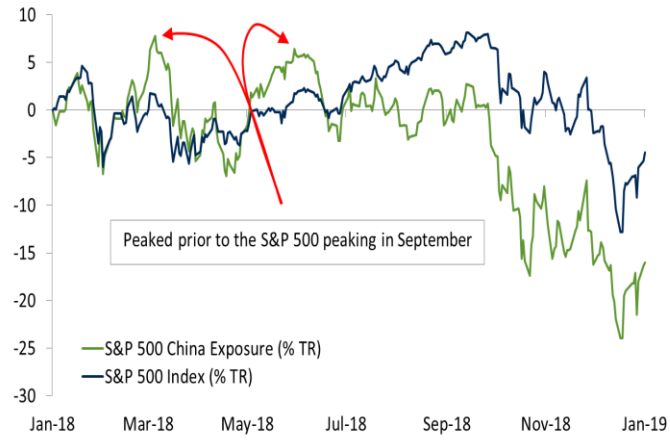

Source: Bloomberg, Raymond James Ltd.

From a market timing perspective, what we find interesting from the chart above is that companies with exposure to China have lead market pullbacks by ~2 months.

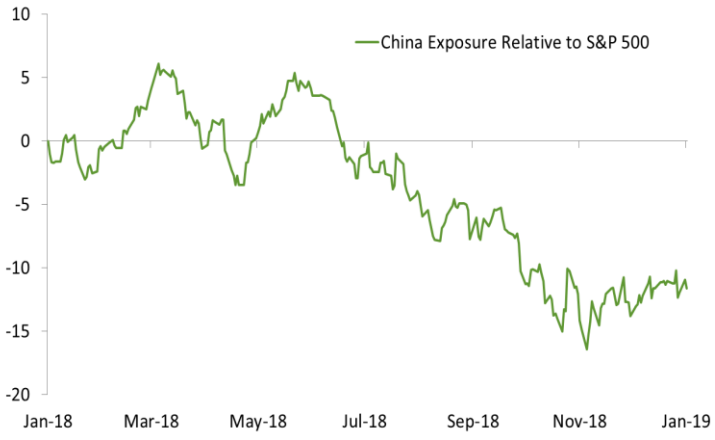
In the charts on the following page, we isolate the most recent performance, which shows companies with China exposure peaked in March, made a lower high in June followed by several weeks of underperformance relative to the S&P 500.

We've incorporated this customized index within our process to help determine inflection points in the market. We'll now be looking for a retest and a higher low, which may suggest the market has found a firmer footing.

## China Exposed Co. Lead the Market Downturn…




## …China Exposure Co. Relative to S&P 500




Source: Bloomberg, Raymond James Ltd.

## Top 20 US Companies with China Exposure

| Ticker | Name | Sector | Market Cap (mln) | Last Price | China % of Revenue | Forward P/E (x) | 1Y Total Return (%) |
|---|---|---|---|---|---|---|---|
| QCOM | Qualcomm Inc | Information Technology | $ 70,257 | $ 56.80 | 67 | 14.3x | -9.5 |
| MU | Micron Technology Inc | Information Technology | $ 40,167 | $ 35.91 | 57 | 4.6x | -17.1 |
| AVGO | Broadcom Inc | Information Technology | $ 102,542 | $249.52 | 49 | 11.0x | -2.0 |
| TXN | Texas Instruments Inc | Information Technology | $ 94,133 | $ 97.72 | 44 | 17.4x | -8.6 |
| IPGP | Ipg Photonics Corp | Information Technology | $ 6,802 | $128.52 | 44 | 17.2x | -49.5 |
| MXIM | Maxim Integrated Products | Information Technology | $ 14,510 | $ 51.72 | 36 | 19.2x | -0.6 |
| AOS | Smith (A.O.) Corp | Industrials | $ 7,889 | $ 46.55 | 35 | 18.1x | -25.6 |
| WYNN | Wynn Resorts Ltd | Consumer Discretionary | $ 12,083 | $111.40 | 34 | 17.1x | -29.9 |
| AMD | Advanced Micro Devices | Information Technology | $ 19,888 | $ 19.74 | 33 | 43.4x | 65.1 |
| AMAT | Applied Materials Inc | Information Technology | $ 33,197 | $ 34.76 | 30 | 10.0x | -33.7 |
| APH | Amphenol Corp-Cl A | Information Technology | $ 24,453 | $ 81.82 | 29 | 22.0x | -7.7 |
| XLNX | Xilinx Inc | Information Technology | $ 22,974 | $ 90.37 | 26 | 26.0x | 24.3 |
| SWKS | Skyworks Solutions Inc | Information Technology | $ 12,413 | $ 68.59 | 25 | 10.0x | -29.3 |
| INTC | Intel Corp | Information Technology | $ 223,825 | $ 48.56 | 24 | 10.9x | 17.1 |
| GLW | Corning Inc | Information Technology | $ 24,060 | $ 30.35 | 22 | 16.8x | -6.7 |
| WDC | Western Digital Corp | Information Technology | $ 11,385 | $ 39.81 | 21 | 5.8x | -49.1 |
| A | Agilent Technologies Inc | Health Care | $ 22,170 | $ 69.90 | 21 | 22.9x | -0.3 |
| TEL | Te Connectivity Ltd | Information Technology | $ 26,657 | $ 78.12 | 20 | 13.7x | -19.2 |
| AAPL | Apple Inc | Information Technology | $ 720,065 | $153.80 | 20 | 12.6x | -10.4 |
| NVDA | Nvidia Corp | Information Technology | $ 88,883 | $145.23 | 20 | 20.2x | -34.9 |

Source: Bloomberg, Raymond James Ltd.

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